

# **Washington State Auditor's Office**

## **Audit Report**

### **Audit Services**

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Report No. 5803

**DEPARTMENT OF SOCIAL AND HEALTH SERVICES**

Agency No. 300

July 1, 1995 Through June 30, 1996

Issue Date: April 18, 1997

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## DEPARTMENT OF SOCIAL AND HEALTH SERVICES

Agency No. 300

July 1, 1995 Through June 30, 1996

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### Overview

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We performed the statewide single audit of the state of Washington for the fiscal year ended June 30, 1996. In accordance with the Single Audit Act of 1984, we audited the state as an entity, rather than each agency separately. The results of this audit will be published in a statewide single audit report which includes the following:

- An opinion on the financial statements.
- A report on internal control structure-related matters based solely on an assessment of control risk made as part of the audit of the financial statements.
- A report on compliance with laws and regulations that may have a material effect on the financial statements.
- An opinion on supplementary Schedule of Federal Financial Assistance.
- A report on internal controls over federal financial assistance.
- An opinion on compliance with specific requirements applicable to major federal financial assistance programs.
- A report on compliance with general requirements applicable to federal financial assistance programs.
- A report on compliance with laws and regulations applicable to nonmajor federal financial assistance program transactions tested.
- A Schedule of Findings and Schedule of Questioned Costs.

The work performed at the Department of Social and Health Services included procedures to satisfy the requirements of the 1996 statewide single audit, and supplemental reviews and tests deemed necessary in the circumstances.

There were findings and questioned costs, which are listed in the Schedule of Findings following this overview, for the Department of Social and Health Services.

**BRIAN SONNTAG, CGFM**  
STATE AUDITOR

February 28, 1997

# DEPARTMENT OF SOCIAL AND HEALTH SERVICES

Agency No. 300

July 1, 1995 Through June 30, 1996

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## Schedule Of Findings

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1. The Department Of Social And Health Services (DSHS), Economic Services Administration (ESA) Should Recover Public Assistance Overpayments Resulting From Fraud

The Community Services Division (CSD) of the ESA has not made adequate attempts to recoup all overpayments resulting from fraudulent actions by recipients of public assistance, including federal funds from the Aid to Families with Dependent Children (AFDC) program.

When a public assistance recipient submits an affidavit swearing that a monthly warrant has been lost or stolen, DSHS cancels the warrant and issues a replacement. In some cases, both the canceled and replacement warrants are then cashed. When this occurs, the DSHS Division of Fraud Investigation (DFI) investigates and notifies the appropriate Community Services Office (CSO) if it finds this action constitutes fraud by the recipient.

The CSOs do not always fulfill their responsibilities to advise recipients of fraud determinations and then to notify the DSHS Office of Financial Recovery (OFR) that receivables must be recorded in the financial records and overpayments must be recouped. In addition, CSD management does not monitor fraud cases to ensure all overpayments are established timely.

During the period January through December 1995, DFI determined fraud was committed in 747 double payment cases where warrants totaling \$360,253 were canceled and then cashed. AFDC funded approximately 50 percent of this amount. Of the 747 cases, 87 involved 33 clients with multiple double payments in multiple CSOs. We reviewed OFR records for all of these 87 cases, totaling \$44,708 in double payments. We found the CSOs never reported 46 of these payments, totaling \$23,207, to OFR, even though DFI had properly notified the CSOs. Because DSHS did not take the required steps to attempt recoupment of these fraudulent payments, we question \$12,269, which is the federal portion of the total unrecovered funds.

This condition was previously reported in our 1994 *State of Washington Single Audit Report*, Finding 4.

*Revised Code of Washington (RCW) 43.08.066 states in part:*

. . . in the event that an original and its duplicate instrument are both presented for payment as a result of forgery or fraud, the issuing officer shall be the state agency responsible for endeavoring to recover any losses suffered by the state.

45 *Code of Federal Regulations* (CFR) 233.20(a)(13)(E) states in part:

. . . A state must take one of the following three actions by the end of the quarter following the quarter in which the overpayment is first identified:

- (1) Recover the overpayment,
- (2) Initiate action to locate and/or recover the overpayment from a former recipient,
- (3) Execute a monthly recovery agreement from a current recipient's grant or income/resources.

. . . The State must maintain information on the individual and total number and amount of overpayments identified and their disposition for current and former recipients.

. . . In cases involving fraud, States must make every effort to recover the overpayment, regardless of the amount.

The DSHS *Manual F: Financial and Medical Assistance*, Chapter 72.10 C.2. requires case workers to establish overpayments based on DFI findings.

The failure to attempt recoupment of fraudulent overpayments may have several effects:

- a. Recipients who are not pursued for the recoupment of double payments obtained as a result of committing fraudulent acts are able to retain funds to which they are not entitled and are encouraged to repeat the same activity.
- b. Services to other recipients may be reduced as state and federal funds are not available for their intended purposes.
- c. The federal government may decide to reduce funding to the state of Washington for the AFDC program.
- d. The public may lose confidence in government's commitment to accountability for public funds.

This situation has occurred in part because the CSD has not emphasized the development of sufficient procedures to ensure attempts are made to recoup fraudulent overpayments. The pressure of an increased number of caseloads handled by a decreased number of staff has made this issue a low priority at the CSOs, particularly since individual warrants are relatively small in amount. In addition, the lack of central agency monitoring of these cases make it extremely difficult for management to ensure all necessary overpayments are being pursued.

We recommend the ESA review, revise and emphasize procedures which will help to ensure CSOs fulfill their responsibilities regarding recoupment of fraudulent double payments to clients. We also recommend the ESA consider developing a monitoring system which is accessible by DFI, OFR, and ESA for tracking these cases.

<u>Federal Agency</u>	<u>Federal Program</u>	<u>CFDA Number</u>	<u>Questioned Costs</u>
HHS	Aid To Families with Dependent Children	93.560	\$12,269

Auditee's Response

*The Department concurs.*

*The Department takes the recovery of overpayments very seriously. As a result, the Division of Management and Operations Support (DMOS) within ESA will develop a tracking system to ensure the timely establishment of future overpayments. This system will track each overpayment from DFI to the establishment of the overpayment at the CSO, and finally, to the recovery of funds at OFR.*

*For the cases identified in this finding, CSOs are presently establishing overpayments and notifying OFR. This process will be complete by April 30, 1997.*

*Finally, a memorandum will be sent to the CSOs reminding them to review, revise and emphasize procedures which will help to ensure each office is fulfilling its responsibility in helping to recoup overpayments to clients.*

Auditor's Concluding Remarks

We appreciate the agency's timely response and commitment to resolution of these issues and thank agency staff members for their cooperation and assistance during our audit.

2. The Department Of Social And Health Service (DSHS) Should Comply With Federal Regulations For The Refugee Assistance Program To Ensure Payments Are Made To Eligible Refugees

During our fiscal year 1996 audit, we visited 11 DSHS Community Service Offices (CSOs) which constituted approximately 25 percent of the CSOs who administer the refugee assistance program. Refugee case files were tested for compliance with applicable eligibility requirements related to the Refugee Cash and Medical Services Grant (CFDA 93.566). We found instances where the following requirements were not met:

- a. Proof of the client's refugee status through Immigration and Naturalization Service documentation - related questioned costs, \$3,384.
- b. Determination of AFDC (Aid to Families with Dependent Children) and Medicaid eligibility be made prior to the establishment of refugee cash and medical eligibility - related questioned costs, \$99,266. However, during the course of our audit these individuals were determined to be eligible for AFDC.
- c. Evidence of contact with the client's sponsoring agency - no related questioned costs.

In addition, ineligible payments were made when:

- d. Refugee assistance payments exceeded the allowable eight-month time period - related questioned costs, \$1,131.

- e. Refugee assistance payments were not terminated once SSI (Social Security Income) eligibility was established - related questioned costs, \$1,523.

45 *Code of Federal Regulations* (CFR), Part 400 states the following criteria:

45 CFR 400.43 (a)(1-6b) states in part:

An applicant for assistance under title IV under the Act must provide proof, in the form of documentation issued by the Immigration and Naturalization Service (INS) . . . .

45 CFR 400.56 (3) states:

If the appropriate State agency determines that the refugee applicant is not eligible for cash assistance under the AFDC program, the State must determine eligibility for refugee cash assistance in accordance with 45 CFR 400.60.

45 CFR 400.100 states in part:

(a) Eligibility for refugee medical assistance is limited to those refugees who- (1) Are ineligible for Medicaid but meet the financial eligibility standards under 45 CFR 400.101 . . . .

45 CFR 400.55 (b) states in part:

In determining eligibility for cash assistance, the State must . . . (3) Verify with the applicant's sponsor or the resettlement agency the amount of financial assistance . . . .

45 CFR 400.55 (b) states in part:

In determining eligibility for cash assistance, the State must . . . (4) Contact applicant's sponsor or the resettlement agency concerning offers of employment . . . .

45 CFR 400.211 (a) states in part:

The time-eligibility period for refugee cash assistance and refugee medical assistance will be determined by the Director each year, based on appropriated funds available for the fiscal year . . . .

According to current Federal determination [which is documented in the *Washington Administrative Code* 388-55], refugees meeting the eligibility requirements can receive refugee cash and medical assistance only during the eight-month period beginning the first month the refugee entered the United States.

45 CFR 400.56 (b)(ii) states in part:

If the State agency determines that a refugee who is 65 years of age or older, or blind or disabled, is eligible for refugee cash assistance, it must furnish such assistance until eligibility for cash assistance under the SSI program is determined . . . .

Management attributes these conditions to the high turnover of CSO financial staff and their unfamiliarity with refugee cash and medical federal regulations.

Failure to comply with federal regulations resulted in inappropriate payments made from the refugee program. Based on our testing of refugee case files we found \$99,266 was inappropriately paid from the Refugee Assistance program for individuals eligible for AFDC and \$6,038 was paid to ineligible individuals. We are, therefore, questioning the total amount of \$105,304 for the Refugee Assistance program.

We recommend DSHS follow federal regulations regarding eligibility determination and verification to ensure that payments to eligible participants in the refugee assistance program are appropriate.

<u>Federal Agency</u>	<u>Federal Program</u>	<u>CFDA Number</u>	<u>Questioned Costs</u>
HHS	Refugee and Entrant Assistance	93.566	\$105,304

Auditee's Response

*The Department concurs.*

*The Department agrees the Refugee and Entrant Assistance grant was inadvertently charged \$105,304. However, the majority of the clients identified are eligible for AFDC. For these clients, \$99,266 will be moved from the Refugee and Entrant Assistance grant to the AFDC and Title XIX grants. The reduction of federal expenditures will be reflected on the following quarterly claim to the federal Department of Health and Human Services.*

*The fully implemented Automated Client Eligibility System (ACES) will prevent the type of payment issues noted in conditions **b**, **d**, and **e** of the finding. Until ACES is fully implemented, ESA will issue a memorandum reminding field staff of these requirements. In addition, ESA will be reminding field staff in writing of the requirements for documenting the client's refugee status, making contact with the client's sponsoring agency, and keeping this documentation in the case file.*

Auditor's Concluding Remarks

We appreciate the assistance ESA staff members provided to us during the course of this audit. Their genuine interest in the audit, as well as their concern for compliance, are both commendable. We look forward to working with ESA personnel in our next audit.

3. The Department Of Social And Health Services (DSHS). Division Of Child Support (DCS) Should Comply With Federal Regulations Relating To The Allowability Of Expenditures

DCS has charged the federal Child Support Enforcement grant for tuition reimbursements. These reimbursements were paid to DCS employees who provided evidence of payment for and successful completion of educational credit (usually college courses).

In state fiscal year 1996, DCS reimbursed its employees \$63,291 in tuition reimbursements of which \$41,772 was the portion charged to the U.S. Department of Health and Human Services (HHS).



The *Code of Federal Regulations* (CFR), Title 45, Subtitle B, Chapter III, Part 304, Section 304.23 states in part:

**Expenditures for which Federal Participation is not available.**

Federal financial participation at the applicable matching rate is not available for . . . (d) Education and training programs and educational services except direct cost of short term training provided to IV-D agency staff . . . .

DCS tuition reimbursement payments processed through DSHS' vendor payment system were incorrectly coded which caused 66 percent (\$41,772) of these payments to be charged to the Child Support Enforcement grant.

To ensure that tuition reimbursement payments are charged appropriately, DCS must direct all tuition reimbursement charges to state funds.

We recommend that DCS charge all tuition reimbursements to state funds. We also recommend that DCS reimburse HHS for the portion of cost charged to federal funds.

<u>Federal Agency</u>	<u>Federal Program</u>	<u>CFDA Number</u>	<u>Questioned Costs</u>
HHS	Child Support Enforcement	93.563	\$41,772

Auditee's Response

*The Department concurs.*

*The majority of federal grants allow expenditures for tuition reimbursement. DCS was unaware of this limitation under the Child Support Enforcement grant. DCS will send a memorandum to the Office of Accounting Services requesting federal expenditures for the Child Support Enforcement grant be reduced by \$41,772. This reduction of federal expenditures will be reflected on the quarterly claim to the federal Department of Health and Human Services for the quarter ending March 31, 1997.*

*Additionally, the DCS Fiscal Management Chief will send a memorandum to staff directing all future tuition reimbursement expenditures to be charged to state only funds.*

Auditor's Concluding Remarks

We appreciate the agency's prompt response and commitment to resolution of this issue and thank the agency staff for their cooperation and assistance during our audit.

4. The Department Of Social And Health Services (DSHS). Mental Health Division (MHD) Should Comply With Laws And Regulations Regarding Salary Limitations And Stand-By Pay

Since July 1995, MHD has increased the approved salary for the exempt position of Western State Hospital superintendent (entitled chief executive officer [CEO]) by compensating the incumbent with stand-by pay of \$3.08 an hour for every hour beyond an eight-hour work day that he is located anywhere within the state. No other DSHS institutional superintendents receive similar additional compensation.

The CEO is also a psychiatrist whose additional medical expertise is already recognized by the Washington Personnel Resources Board (WPRB) in its position description of "Superintendent, Western State Hospital (Med)." The salary range for this position is 17

ranges above "Superintendent, Western State Hospital (Non-Med)." The WPRB has set the maximum allowable salary for this position at \$9,053 a month or \$108,636 yearly. MHD placed the WSH CEO at this salary level when it appointed him to the position.

A July 25, 1995, memo from the previous MHD director to the previous assistant secretary for the Health and Rehabilitative Services Administration describes and authorizes the plan to have the CEO assume all of the administrative stand-by hours previously assigned to various clinical directors. It states in part:

. . . Effective July 28, 1995, I have asked (the superintendent) to be available continuously to provide . . . administrative on-call responsibility . . . This is being done as an interim measure while other personnel actions are initiated in order to pursue a salary increase for the Chief Executive Officer/Medical Director position.

Neither MHD nor the WPRB could provide us with any documentation demonstrating that these other personnel actions have been pursued during the past 20 months. According to the WPRB, the last WPRB upgrade for the CEO's position occurred in 1992.

During fiscal year 1996 and for the first half of fiscal year 1997, the CEO was reimbursed for 5,205 and 3,104 stand-by hours, respectively, or an average of 107 hours a week. According to the CEO, this additional stand-by compensation occurred no matter where he was located within the state, including his home, approximately 50 miles from WSH. He has received additional remuneration of \$16,095 and \$9,560, respectively, for these time periods. Of the total \$25,655, we question the \$12,629 financed by federal funds from Title XIX Medicaid.

In general, the superintendent's position is exempt from civil service laws (RCW 41.06.076). The salary and fringe benefits for the position, however, are determined by the Washington Personnel Resources Board (RCW 41.06.070(3)).

Based on legal advice, we have concluded that this statute has the effect of placing salary and fringe benefits for exempt positions under applicable sections of the Compensation Plan Appendix contained in the *Washington Administrative Code* (WAC).

WAC 356-15-080(1) states in part:

- a. An employee is in standby status when not being paid for time actually worked and both (emphasis added) of the following conditions exist:
  - (1) The employee is required to be present at a specified location. The location may be the employee's home or other specific location . . .
  - (2) The agency requires the employee to be prepared to report immediately (emphasis added) for work if the need arises . . .
- b. An agency may issue a written policy stating that an employee is in standby status . . . while required to leave a telephone number with the agency or remain in communication with a dispatching authority to respond to a call to begin work in a specified time limit . . . .

This situation is not in compliance with subsection (a), as the CEO is not required to be at a specified location while on standby status. DSHS has not developed a policy in conformity with subsection (b).

The Office of Management and Budget Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, states in part in Section C, the basic guidelines:

1. . . . To be allowable under Federal awards, costs must meet the following general criteria:

- a. Be necessary and reasonable for proper and efficient performance and administration of Federal awards.
- c. Be authorized or not prohibited under State or local laws or regulations.

By unilaterally increasing the WSH superintendent's salary, MHD has circumvented the WPRB's authority to set salaries for exempt personnel and has granted stand-by pay not in conformance with state law.

We recommend the following to MHD:

- a. Immediately cease enhancing the WSH CEO's salary with continuous stand-by pay until such action is in conformance with state law.
- b. Recover any portion of the CEO's additional salary which resulted from periods of time when he was physically situated so that he could not have met the WAC description of "on-call."
- c. Reimburse Title 19 Medicaid for its share of the unallowable costs.

<u>Federal Agency</u>	<u>Federal Program</u>	<u>CFDA Number</u>	<u>Questioned Costs</u>
HHS	Title XIX Medicaid	93.778	\$12,629

Auditee's Response

*The Department does not concur.*

*MHD has asked for advice from the Assistant Attorney General (AAG) and the issue is currently under review. MHD will consider the recommendation of the AAG prior to taking any action.*

Auditor's Concluding Remarks

We commend MHD for the decision to confer with its AAG on this issue and suggest that the Department of Personnel (DOP) is another excellent resource for this and any future salary or stand-by questions. We conferred with both the State Auditor's Office AAG and DOP personnel in reaching our conclusions. We reaffirm our finding.

- 5. The Department Of Social And Health Services (DSHS). Mental Health Division (MHD) Should Improve Contract Monitoring

MHD has not developed and implemented sufficient procedures to ensure adequate monitoring of its contracts with Regional Support Networks (RSNs) and other entities. We found the following conditions:

- a. **RSN contracts:** MHD has implemented procedures to identify variances between expenditures reported by the RSNs on the Federal Mental Health Block Grant (MHBG) Service Reports and reimbursements made by MHD to the RSNs for these services. However, it still has not completely implemented procedures to follow up on those identified variances. Variances ranged from an apparent underpayment of \$101,304 to an apparent overpayment of \$184,786 to a different RSN. This condition previously was reported in our 1994 and 1995 *State of Washington Single Audit Reports*.
- b. **Other contracts:** MHD has not developed adequate procedures to ensure it pays contractors only after receiving sufficient evidence that payments are justified. We tested seven non-RSN contracts with fiscal year 1996 expenditures totaling \$622,636. For two of these contracts, MHD accepted billings which were submitted without adequate descriptions of the work performed and then disbursed \$208,721 without monitoring to ensure that contract deliverables were obtained. We question this amount, all of which was expended from MHBG funds.

*Code of Federal Regulations* (CFR) 45 Section 92.20 (b)(3) states:

Effective control and accountability must be maintained for all grant and subgrant cash, real and personal property, and other assets. Grantees and subgrantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes.

Office of Management and Budget's Circular A-87, Attachment A, Section C.1 states that, to be allowable under Federal awards, costs must be necessary, reasonable and adequately documented.

The State of Washington Office of Financial Management *Financial and Administrative Policies, Regulations and Procedures* manual states in part in Section 6.2.2.1.3.b:

Disbursements are to be handled in such a manner as to ensure . . . that the disbursement is used only for authorized purposes . . . .

The lack of monitoring controls over MHBG funds disbursed to RSNs and other contractors increases the risk of misuse or loss of funds intended to provide mental health services. Failure to monitor the use of federal funds for allowable purposes could jeopardize future federal funding.

MHD attributes these conditions to the division's focus on program outcomes rather than fiscal reconciliations. We also attribute the second condition to the format of some of the MHD contracts, which fail to link specific contracted amounts to specific required activities.

We recommend that DSHS implement procedures to follow up on variances between the RSN Service Reports and MHD expenditures. We also recommend that DSHS improve monitoring procedures to ensure it pays contractors only after receiving sufficient evidence that payments are justified. We further recommend that DSHS design contracts which associate specific amounts with specific deliverables.

Federal

Federal

CFDA

Questioned

<u>Agency</u>	<u>Program</u>	<u>Number</u>	<u>Costs</u>
HHS	Block Grants For Community Mental Health Services	93.958	\$208,721

Auditee's Response

*The Department concurs with condition **a** of the finding but does not concur with condition **b**.*

*For condition **a**, MHD will direct its contract liaison staff to follow up and resolve identified variances between expenditures reported by the RSNs and disbursements made by MHD to the RSNs for MHBG related services.*

*For condition **b**, the Department believes it acted in accordance with the stipulations of the two contracts identified in the finding. Therefore, the Department does not concur with the questioned costs. While the Department does not plan to amend its current contracts, we plan to ensure the language in future MHD contracts is strengthened to clarify the billing requirements necessary to support payments made by the agency.*

Auditor's Concluding Remarks

We appreciate MHD's concurrence with condition a. and its plan to begin resolution of condition b. by clarifying contract language regarding billing requirements. However, we believe MHD also needs to develop and routinely implement adequate monitoring procedures, regardless of individual contract stipulations. Requiring contractors to provide supporting documentation will have maximum value only when MHD then reviews this documentation to ensure contract deliverables are completed before payment. Since we found inadequate support for and monitoring of the two contracts cited in the finding, we reaffirm our finding and the questioned costs.

6. The Department Of Social And Health Services (DSHS) Should Improve Controls Over The Social Services Payment System (SSPS)

Our examination of internal controls over SSPS at 30 DSHS field locations revealed the following weaknesses:

- a. Individuals had the capability to authorize both providers and payments.
- b. Individuals no longer working at the DSHS field location still were authorized for system access.
- c. There was not always an independent reconciliation of output to input.
- d. Individual passwords were not always changed on a periodic basis.
- e. Division of Children and Family Services (DCFS) staff functions did not correspond to either the SSPS or Case And Management Information System (CAMIS) security access listing.
- f. Lack of formal SSPS training from the regional and headquarter offices.

Conditions a-d were previously reported in our 1995 *State of Washington Single Audit Report*, Finding 54.

The State of Washington Office of Financial Management (OFM) *Policies, Regulations, and Procedures* manual prescribes the following:

Section 6.1.1.2.4.b(1):

Division of Duties - Whenever possible, no individual is to have complete control over any type of asset in any agency, department, or division of the state.

Section 6.2.2.1.11.j:

Controls are to be in place which safeguard and limit access to data processing equipment, tapes, disks, files, system documentation, and application program documentation to authorized employees.

SSPS operations personnel attribute these weaknesses to a lack of adequate training regarding revised policies and procedures concerning access to the system at the local level and failure to ensure staff awareness of existing internal control policies and procedures.

Lack of adequate control procedures increases the risk that errors or irregularities could occur and not be detected.

We recommend that DSHS:

- a. Limit SSPS input capability so that one individual does not have the capability to input both providers and payment authorizations. In small field offices where this is not feasible, DSHS should implement adequate compensating controls.
- b. Remove access to SSPS for individuals whose job responsibilities no longer require it.
- c. Perform independent reconciliations of SSPS input and output to ensure validity and accuracy of all payments.
- d. Ensure that system edits require the users to change their passwords on a periodic basis.
- e. Review security access listing reports at the SSPS management level.
- f. Provide formal training at the local level for proper use of SSPS.

Auditee's Response

*The Department concurs.*

*In response to the Fiscal Year 1995 Single Audit, sound business practices training was presented statewide to DSHS field managers. This training included requirements for: separation of duties, changing of security codes and access, and performing independent reconciliation. However, the Office of the State Auditor began their field work concurrent with the training sessions, and the issues identified in the Fiscal Year 1996 audit occurred prior to the completion of training. As a result of this training, we expect compliance with SSPS procedures to improve. The Department will continue to present this training annually.*

*DSHS is also developing an internal control training course which will be required for all departmental managers.*

*In addition, SSPS Operations staff meet at least annually with regional SSPS Coordinators to provide training information and to discuss audit issues and related corrective actions. Each local office has an SSPS Coordinator. Training for staff on the proper use of SSPS is available through the local coordinator. Formal training from SSPS staff is also available upon request. Managers are encouraging their staff to take advantage of all available training resources.*

*Regarding recommendation d, the requirement to fix the Year 2000 date problem in SSPS precludes the Department from installing any system edits at this time. Until the Year 2000 programming changes are completed, the Department will continue to implement sound controls over security codes and access.*

#### Auditor's Concluding Remarks

We appreciate the agency's timely response and commitment to resolution of these issues and thank agency staff for their cooperation and assistance during our audit. We will again review controls at the field locations and will review the corrective action taken on these issues during the course of our next audit.

7. The Department Of Social And Health Services (DSHS), Division Of Child Support (DCS) Should Improve Internal Controls Over Cash Receipts

Our audit of cash receipts at five DCS field locations and at the DCS headquarters office revealed the following common control weaknesses:

- a. Mail containing remittances is not always opened properly by two people or more.
- b. Remittances received by mail are not always listed in duplicate or restrictively endorsed immediately when they are extracted from the envelopes.

In addition, our audit indicated the following control weaknesses at the DCS field locations:

- c. Field Office Counter Cash Logs (FOCCL) are not being properly completed or distributed appropriately by counter personnel.
- d. Reconciliations of cash receipts to bank deposits are being performed by an employee not independent from cash processing.
- e. Counter cash receipt books are not adequately controlled, accounted for, or completed.

We also noted at the DCS headquarters office that:

- f. Deposits are not always made within 24 hours of receipt.

The State of Washington Office of Financial Management (OFM) *Policies, Regulations, and Procedures* manual states in section 6.2.2.1.1.c.:

Mail is to be opened by two persons. Remittances by mail are to be listed in duplicate at the time the mail is opened. The listing is to be prepared by a person other than the one opening the mail. One copy of the listing

is to be forwarded to the cashier with the receipts. The other copy is to form the basis for accounting controls through ledger posting. The listing is to be periodically compared with the deposit by a third person.

Section 6.2.2.1.1.b. states:

Incoming cash is to be made a matter of record as soon as possible.

Section 2.2.4.1.1.a. states in part:

Cash receipts . . . are to be deposited intact within 24 hours of receipt . . . unless a specific written waiver is granted by the Office of State Treasurer . . . .

Section 6.1.1.2.4.b.(2) states:

Every effort is to be made to ensure that the assets of the state are properly handled. By supplying employees with strict control procedures and ensuring that they are followed through the use of checks and audits, the chance of losses will be greatly decreased.

Control weaknesses found at the field locations are attributable to inadequate written procedures and lack of knowledge relating to internal controls in the proper handling of cash receipts. At the DCS headquarters office, control weaknesses are attributed to the volume of checks received daily.

The lack of adequate controls over cash receipts increases the risk that errors or irregularities could occur without detection. In addition, there is a loss of interest earnings to the state when deposits are delayed.

DCS management has acknowledged the aforementioned control weaknesses and has been in the process of developing written policies and procedures for handling cash receipts at field office locations. DCS is close to implementing the use of imaging technology and has been developing improved office security at headquarters to help address their control weaknesses.

We recommend that DCS develop and implement the necessary procedures to provide effective internal controls over cash receipts at all locations.

#### Auditee's Response

*The Department concurs.*

*The Department has expended a substantial amount of effort in correcting the issues noted in the Fiscal Year 1995 Single Audit Report. However, the Department believes SAO has not allowed sufficient time to implement all of the necessary changes. To date, we believe we have been successful in our efforts to develop effective internal controls over cash receipts.*

*DCS has evaluated both headquarters and field cash receipt activities and procedures. Policies and procedures have been established and implemented to create sound controls over: the opening of mail; restrictive endorsement; safeguarding of cash receipt books; creation and distribution of cash logs; timely deposits, and reconciliation of receipts to deposits. DCS headquarters will monitor to ensure continued adherence to these procedures.*



*Additionally, on March 7, 1997, DCS successfully completed a one year project implementing the Financial Management Imaging System. Implementation of this system greatly enhances the safeguarding, documentation, and deposit of cash receipts received at DCS headquarters.*

*DCS believes the two initiatives identified above will not only resolve the issues identified by the State Auditor, but also create more efficient business practices over receipting activities.*

#### Auditor's Concluding Remarks

We appreciate the agency's commitment to strengthening controls over cash receipts in DCS. We will review the corrective action taken on the issues during the course of our next audit.

8. The Department Of Social And Health Services (DSHS) Should Comply With OFM And Agency Policies And Procedures Requiring Control Over Fixed Assets

DSHS is not complying with OFM and agency policies and procedures requiring control over its fixed assets. We conducted procedures at headquarters and at eleven field offices, composed of four Community Services Offices (CSOs), three offices of the Children's Administration (CA), three Offices of Support Enforcement and one office of the Juvenile Rehabilitation Administration. We found the following conditions:

- a. At the field locations, we compared equipment items, equipment purchasing records, and Agency Inventory System (AIS) data for the same equipment and found field personnel:

(1) Cannot always track equipment listed in the AIS data base to its recorded physical location to verify its existence. At each location, we selected 10 items which the AIS indicated were in the custody of that office. We found CA and CSO field personnel were unable to physically locate 18 of the 30 items and 6 of the 40 items, respectively. The items were either surplus, lost, stolen, or transferred without proper documentation. All selected items at the other offices we visited were located.

(2) Are not always properly entering equipment items found at their locations to their respective inventory listings. We selected 5 items of tagged equipment at each office and attempted to trace them to the AIS data base. In the CA and CSO locations, the inventory lists did not include records for 10 of the 15 items and 4 of the 20 items, respectively. In addition to the selected items, we noted at two of the CA offices a total of more than 100 tagged computer units not added to their location inventory listings. Equipment items at the other locations we visited could be traced to inventory listings.

- b. At headquarters, we compared purchasing documents, accounting records, and data input to the AIS for 20 purchases from the agency as a whole. These 20 purchases ranged in value from \$820 to \$1,003,572 and totaled \$1,328,926. We found:

(1) Field accounting personnel are not always recording the correct expenditure coding for purchases. For 7 of the transactions, personnel had misapplied the codes used to distinguish capitalized from noncapitalized assets. The amount of \$1,056,087 was miscoded as capitalized equipment on the purchase documents.

(2) Field office AIS representatives are not always properly entering required data from the equipment purchase documents to the AIS. We found inaccuracies in 8 of

the documents tested. Most of these inaccuracies were understatements of cost resulting from the failure to include the cost of sales tax and shipping.

- c. DSHS is not reconciling capitalized and small and attractive asset expenditure records against additions to fixed assets in the AIS to ensure that all applicable purchases are included in inventory records. These reconciliations are not being performed at the local office or headquarters level.

The above conditions were reported in varying combinations in our *State of Washington Single Audit Report* from 1982 to 1993 and 1995.

The State of Washington Office of Financial Management (OFM) *Policies, Regulations, and Procedures* manual lists the following internal control and accounting requirements for fixed assets:

Section 3.2.2.1.2.b:

A satisfactory fixed asset inventory system must include mechanisms and procedures for controlling the addition to and removal of assets from inventory . . . .

Section 3.2.2.2.1:

Immediately, upon receipt and acceptance of an inventoriable fixed asset, the inventory officer is responsible for supervising the addition of the asset to the inventory system. This includes the assignment of tagging responsibilities to specific individuals as well as the development and implementation of procedures to ensure that the necessary information is entered into the fixed asset inventory records.

Section 3.2.2.2.2.a:

Agencies are to adopt internal policies and procedures regarding the timely removal of fixed assets from inventory . . . .

Section 3.2.2.2.5.e:

. . . Unrecorded assets are to be entered into the inventory system as soon as possible after discovery. If a significant number of unrecorded assets are located, indicating a major problem with the asset recording procedures, the inventory officer is to determine why the problem is occurring and correct it.

Section 3.2.2.3.2.a:

. . . An annual reconciliation with the inventory records is to be made to determine if all tagged assets are being properly entered in the inventory.

Section 3.1.2.2.1.b:

. . . Valuation of purchased assets is to be made on the basis of historical costs including all nonrefundable purchase taxes (e.g., sales taxes), and all appropriate ancillary costs less any trade discounts or rebates . . . .

Section 2.2.4.6.1:

. . . Fixed assets with a unit cost of \$5,000 or more are capitalized . . . .

Section 7.2.6.2. of the same manual describes the use of separate expenditure codes for capitalized assets and noncapitalized assets. The latter code, to be used for all fixed assets under \$5000, includes, but is not restricted to, small and attractive fixed assets.

To ensure compliance with OFM regulations, DSHS has developed a new Asset Management (AM) Manual, which covers most aspects of fixed asset management. The AM Manual includes Administrative Policy No. 14.07, which requires each division director to ensure the provisions of the AM Manual are carried out and to take corrective action when required.

Administrative Policy No. 16.05 requires agency managers to establish and maintain an effective system of internal controls to assure compliance with department policies and procedures and with applicable laws and regulations.

Without following proper control procedures, the potential for loss, unauthorized use, and misappropriation of fixed assets increases. Without proper reconciliation procedures between the capital expenditures and AIS, the ability to detect inventory accounting errors or other irregularities is reduced. In addition, the existence of most of the conditions provides little assurance that the agency's fixed asset balance is fairly presented.

DSHS has made significant improvements by creating the new Asset Management Manual and organizing a structure of responsibility throughout the agency. However, we believe the above conditions continue to occur, although with less frequency, because many managers and AIS representatives are still unaware of their ultimate responsibility for fixed asset management or have assigned this responsibility a lower priority. In addition, field AIS representatives appear confused about which costs should be included in the total purchase price added to the AIS, and field accounting personnel appear confused about what costs should be capitalized. In response to these problems, the agency's Asset Management Section has begun an extensive training program for employees responsible for asset accountability.

The agency has also given a lower priority to developing a system to periodically reconcile its expenditures for capitalized and small and attractive assets to its inventory data base. We believe that DSHS cannot hope to acquire adequate physical and accounting control over these assets until it devises a system that will require such an ongoing reconciliation.

We recommend that DSHS:

- a. Ensure that division managers, AIS representatives, and accounting personnel are adequately informed of OFM and agency policies and procedures for fixed asset management and accountability and of their responsibilities for compliance.
- b. Institute procedures requiring the periodic reconciliation of capitalized and small and attractive fixed asset expenditures to additions in the AIS.

Auditee's Response

*The Department concurs.*

*The four CSOs noted in the finding have either corrected or are in the process of correcting the identified deficiencies. Economic Services Administration (ESA) has developed a corrective action plan to assist all offices in complying with DSHS's revised Administrative Policy for Fixed Assets (14.07).*

*During the time of the audit, the Children's Administration was undergoing a complete replacement of local area networks and personal computers. Because of the volume of new equipment coming into the system, input into the Agency Inventory System (AIS) was delayed. During the replacement period, inventory information was maintained on a data base tracking system. Although AIS data entry did not occur immediately, the administration knew the location of every piece of old and new equipment at all times.*

*A new Asset Management Manual, a revised Administrative Policy 14.07, and significant changes to AIS coupled with extensive training of personnel will assist DSHS in managing fixed assets more accurately and effectively.*

#### Auditor's Concluding Remarks

We appreciate the agency's timely response and commitment to resolution of these issues and thank agency staff members for their cooperation and assistance during our audit.

9. The Department Of Social And Health Services (DSHS) Should Restrict The Number Of Exempt Position Appointments To Those Authorized By State Law

DSHS is not restricting the number of appointments to exempt positions to those authorized by statute. We reviewed the agency report of exempt employees and identified 12 instances where more than one person at a time has been filling an exempt position. We evaluated the reason for each double-fill and the length of time the situation has existed. We determined that there was no satisfactory explanation for double-filling ten of these positions. In five of the ten cases, the extra employee has been responsible for duties which do not correspond in any respect to the position description.

This condition was previously reported in the 1995 *State of Washington Single Audit Report*, Finding 77.

RCW 41.06.070(1)(y) authorizes the following exempt positions in each agency with 50 or more employees:

. . . Deputy agency heads, assistant directors or division directors, and not more than three principal policy assistants who report directly to the agency head or deputy agency heads.

RCW 41.06.076 authorizes the following specific exempt positions for DSHS:

. . . the secretary; the secretary's executive assistant, if any; not to exceed six assistant secretaries, thirteen division directors, six regional directors; one confidential secretary for each of the above-named officers; not to exceed six bureau chiefs; and all superintendents of institutions of which the average daily population equals or exceeds one hundred residents . . . .

RCW 43.20A.090 authorizes a seventh assistant secretary for DSHS:

. . . The secretary shall appoint an assistant secretary to administer the juvenile rehabilitation responsibilities required of the department . . . .

These positions are exempt from Merit System Rules, which govern the appointment, promotion, transfer, retention, and classification of state employees. Salary and fringe benefits are determined by the state personnel board in accordance with the provisions of RCW 41.06.070.

RCW 41.06.070(3) allows the Washington Personnel Resources Board (WPRB) to provide further exemptions following requests by the Governor or other elected officials and public hearings held by the WPRB. The statute sets certain limits on the total allowable number of these additional exemptions. The WPRB is required to report to the Legislature all exemptions granted, together with the reasons. The strict controls provided by this statute confirm our belief that the Legislature does not intend the allowable number of exempt positions to be circumvented.

Based upon legal advice, we have concluded that the language utilized in these exemption statutes indicates each exempt position is to be filled by only one person. The numerical restrictions contained in RCW 41.06.076 would be meaningless if DSHS were permitted to fill the restricted number of positions with an unlimited number of persons. The statutes exempt specific positions. Thus only one person actually performing the assigned duties of the designated exempt position may be placed in that position.

By placing two or more employees in the same position concurrently, DSHS has created more exempt employees than the number to which it is statutorily entitled. These additional exempt employees are being compensated at the same rates as the legitimate holders of the positions, even though the job responsibilities in many cases are different.

We recommend that DSHS cease appointing employees to exempt positions which already have incumbents, unless there is sufficient justification to do so and then only for limited periods of time. We also recommend that the agency eliminate the existing double-fills for which no satisfactory justification exists.

#### Auditee's Response

*The Department does not concur.*

*RCW 41.06.070 (3) gives agencies the ability to establish exempt positions beyond what is allowed in RCWs 41.06.070(y), 41.06.076 and 43.20A.090. Under these provisions, DSHS utilizes doublefills to meet critical departmental needs. We believe that double-filling exempt positions on a temporary basis is necessary to effectively manage a dynamic organization. The Department reviews double-filled positions at least monthly to monitor appropriate use. At the time of this response, the Department has only five double-filled exempt positions. All these doublefills are being used appropriately at this time.*

#### Auditor's Concluding Remarks

The language used in RCW 41.06.070(3), discussed both in the finding and in the DSHS response, is quite clear. It does not allow agencies to establish exempt positions beyond those specifically granted. It does allow the WPRB to do so, but only at the request of elected officials and only after public hearings are held. Further, the WPRB must justify these additional exemptions to the Legislature. In none of the ten instances we cited did DSHS ask the Governor to request an exemption; therefore, the statute cannot serve as justification for the questioned doublefills. We reaffirm our conclusion that DSHS is continuing to circumvent statutory limitations on its allowable number of exempt employees.

10. The Department Of Social And Health Services (DSHS) Should Implement Adequate Controls Over Cash At The Institutions And Regional Field Offices

DSHS has not implemented sufficient internal controls over cash to ensure accountability and the prevention and detection of errors or misappropriations. The agency is responsible for the proper accounting for and safeguarding of state cash both in General Fund petty cash and in local funds over which the agency has total control. As agent for the residents of its institutions, DSHS performs these same functions for resident funds.

We found the following deficiencies, in varying combinations and without compensating controls, in 10 of the 12 institutions and regional offices we visited. We noted particular problems at Fircrest School and the Child Study and Treatment Center (CSTC). We found all of the listed deficiencies at Fircrest and the first three at CSTC.

- a. Policies and procedures are not sufficient to ensure the staff's proper use of and accountability for resident cash.
- b. Responsibilities are not always assigned in a manner that will ensure proper division of duties between receipting, accounting for, and disbursing of cash.
- c. Access to safes is not always sufficiently limited to ensure the security of cash.
- d. Cash is sometimes maintained at the institution resident facilities in multiple unsecured locations. Records are insufficient to identify the custodian and authorized amount at each location.
- e. Petty cash:
  - (1) Transactions sometimes are not supported by adequate documentation.
  - (2) Documentation is not always available designating the individual assigned as trustee, the authorized amount to be accounted for, and the purposes for which the funds will be used.
  - (3) Is often used inappropriately for expenditures that are not of an emergency or minimal nature.
- f. Internal surprise cash counts are not routinely conducted.
- g. Records for both resident cash and General Fund petty cash are insufficient to ensure funds are completely accounted for.
- h. Cash is maintained in the Fiscal Office safe without sufficient explanation, documentation or authorization.
- i. Supervisory personnel have not been trained to recognize signs of possible misappropriations of funds and to take required actions when a loss is suspected.

*Revised Code of Washington (RCW) 74.13.060 states in part:*

The secretary . . . shall be the custodian . . . of such moneys and other funds of any person which may come into the possession of the secretary during the period such person is placed with the department of social and health services . . . .

RCW 42.26.060 states in part:

The use of the petty cash account shall be restricted to miscellaneous petty or emergency expenditures . . . .

The State of Washington Office of Financial Management's (OFM) *Policies, Regulations, and Procedures* manual, Section 2.2.4.1.5.b.(2) describes the authorized uses of treasury petty cash accounts.

The OFM manual, Section 2.2.4.1.4.a.(1) states in part:

Daily, cash is to be counted and reconciled with the appropriate records reflecting the day's transactions. All differences are to be investigated to ascertain the reason for the discrepancy . . . .

Section 2.2.4.1.5.a.(3) states:

The agency head (or authorized designee) is to issue and maintain on file a letter designating the individual assigned as custodian, the amount of the petty cash account, and the purpose for which the monies will be spent.

Section 2.2.4.1.5.b.(3)(a)-(c) describes the documentation required to support petty cash disbursements. In addition, Section 6.2.2.1.2.(d) states in part:

All disbursements from petty cash accounts are to be supported by original (no photocopies) receipts or vouchers bearing the signature of the payee.

Section 2.2.4.1.5.(3)(f) states in part:

The total cash on hand, plus the amount of disbursements represented by the documentation, is to equal the authorized amount of the petty cash account . . . .

Section 2.2.4.1.5.b.(3)(g) states:

There are to be frequent, periodic audits of the petty cash account. The audits are to be performed by the agency's Internal Auditor or another individual (not the petty cash custodian) designated by the agency head.

Section 6.1.1.2.4.b(1) states:

Division of Duties - Whenever possible, no individual is to have complete control over any type of asset in any agency, department, or division of the state. The work of employees handling public assets should be complementary to or checked by other employees. This will not only decrease the chance of loss by means of fraud or dishonesty, but will also provide a means to detect errors.

Section 6.2.2.3.1. states:

In the event of the suspected loss of public funds, it is important that correct procedures are followed in order to minimize the loss, ensure that investigations are not hampered, ensure that improvident settlements are

not made, ensure that bond claims are not jeopardized, and ensure that incorrect personnel actions are not taken.

The DSHS Office of Accounting Services has developed a local funds manual to expand on the above requirements and designate procedures the agency expects to be taken. In addition, some of the agency divisions have developed further procedures specific to their institutions.

The deficiencies noted above, particularly in combination, create situations which increase the risk that errors or irregularities may occur and not be detected in a timely manner. During our conduct of surprise cash counts at all institutions visited, personnel were sometimes unable to reconcile the cash on hand to the amount of cash for which they were accountable. CSTC personnel were unable to reconcile total cash on hand plus expenditure records with the authorized balance of petty cash. Because of inadequate documentation and commingling of funds, Fircrest personnel could not verify for us that they had accounted for and safeguarded all petty cash and resident funds.

These deficiencies at the institutions and regional field offices appear to be arising from a lack of adequate training regarding OFM and agency policies and procedures and from increasing duties delegated to decreasing staff.

We recommend DSHS implement sufficient internal controls over cash to help ensure accountability and the prevention and detection of errors or misappropriations. We also recommend DSHS provide sufficient training in these areas to institution and regional office personnel.

#### Auditee's Response

*The Department concurs.*

*The Mental Health Division has developed cash control policies and procedures at the Child Study and Treatment Center (CSTC). The Chief Accountant at CSTC will ensure that policies and procedures are implemented and staff is trained.*

*The Division of Developmental Disabilities (DDD) has drafted new policies and procedures for handling the various cash accounts at the Fircrest School with specific attention focused on accountability and control. Additionally, the Department will provide training for the appropriate Fircrest and Regional Office staff.*

#### Auditor's Concluding Remarks

We appreciate the agency's timely response and commitment to resolution of these issues and thank agency staff members for their cooperation and assistance during our audit.

11. The Department Of Social And Health Services (DSHS) Should Improve Compliance With Regulations Regarding Agency Risk Assessments And Internal Control Evaluations

In Administrative Policy No. 16.05, DSHS has established certain procedures for assessing its areas of risk and for performing evaluations of its internal controls. The agency requires staff members at each of its hundreds of locations to complete an annual checklist designed to confirm the existence and assess the adequacy of controls. The list, which is prepared and distributed by the Office of Operations Review (OOR), is divided into sections, with questions in each section which must be considered and answered positively or negatively. The agency requires each location to submit to the Office of Accounting Services (OAS) a



certification of checklist completion and a corrective action plan for any question answered in the negative. OAS is to identify repetitive areas of concern and provide all documents and information to OOR, which is the agency's internal audit office. The chief of OOR has been designated as the agency's internal control officer for these risk assessments.

During our examination of these procedures, we found the following conditions:

- a. The fiscal year 1996 checklist prepared by OOR and sent to DSHS offices in May 1996 was not complete in two areas. With the exception of the Social Services Payment System, questions were not included to assess controls over specific payment systems making significant annual disbursements for goods and services. Generic disbursement questions were scattered in several sections and were not inclusive of all applicable controls. Additionally, the checklist did not contain a section regarding controls over petty cash, an area of high risk for error, misuse, and misappropriation.

By matching weaknesses found during our various audit tests to location responses for comparable areas, we attempted to determine whether locations were adequately considering their checklist responses. Because of the risks involved, a major portion of our audit procedures included testing petty cash and disbursements for goods and services. However, because of the incomplete checklist, we were unable to ascertain if personnel at the various DSHS locations had evaluated the applicable internal controls.

OOR personnel stated these omissions occurred in the process of restructuring the checklist. Because of the omissions, DSHS is unable to rely on the checklist to determine if adequate controls exist in two areas of great importance to the agency. (We noted that, during this restructuring, DSHS did enhance the checklist in other areas by adding assessments related to weaknesses previously identified by the State Auditor's Office.)

- b. OAS did not designate a staff member responsible for tracking the return of certifications and corrective action plans resulting from the fiscal year 1995 checklist and for following-up on completion of the plans during fiscal year 1996. The certifications and corrective action plans for this checklist were not due until the end of fiscal year 1995. Procedures to fulfill corrective action plans were to be completed by December 1995. During these fiscal year 1996 time periods, no one ensured that all fiscal year 1995 certifications were received and logged in nor that all planned corrective action did eventually occur. Agency personnel had to search for the appropriate documents when we requested them and cannot assure us that the documents found and submitted to us were complete. For instance, OAS did not obtain any fiscal year 1995 certifications or corrective action plans from the Juvenile Rehabilitation Administration during fiscal year 1996.

Because of these omissions, the agency cannot be certain that its procedures for evaluating, certifying and completing corrective action were followed. According to OAS staff members, this condition occurred when changes in divisional responsibility led to a breakdown in communications regarding the designation of a responsible party.

We noted OAS has designated a responsible party for tracking the receipt of responses related to the fiscal year 1996 checklist, which was sent out in May 1996 with a due date of mid-June 1996. However, a number of these responses,

including those from the Juvenile Rehabilitation and Medical Assistance Administrations, had not arrived as of mid-February 1997.

- c. Checklist responses generated at the various locations were not always accurate. At 31 locations, our audit identified various types of control weaknesses in areas which were included in the checklist. We compared these weaknesses to checklist responses at 10 of the locations and found personnel at all 10 locations had responded that adequate controls were in place.

Because checklist answers often were unjustifiably positive, the agency did not receive reliable information on which to base overall risk evaluations. Based on our various audit procedures, we believe this condition occurred because location personnel did not always understand the necessary elements of adequate internal control and did not always devote sufficient consideration to the appropriate responses for checklist questions.

The OFM *Policies, Regulations and Procedures* manual, Section 6.1.1.1.5 states in part:

Chapter 2 of this policy contains internal control procedures, risk assessment checklists, and internal control checklists relating to specific types of assets and transactions . . . Agencies are encouraged to evaluate their environment and develop alternative methods or checklists that are specific to their individual needs. Alternative methods or checklists developed by agencies are to include, at a minimum, the areas from the general checklists that apply to their specific situation.

The cited OFM chapter includes checklists for both disbursements and petty cash.

Section 6.1.1.2.1. of the OFM manual also states in part:

- b. The manager of each organizational unit . . . within an agency is responsible for internal control in that unit. The internal control officer is responsible for assuring that the agency has performed the required risk assessments and performed the evaluative processes . . . A risk assessment of agency internal control systems is to be made annually. An internal control evaluation is to be made when the risk assessment indicates a high level of risk associated with an agency internal control system.

We recommend that DSHS review its risk assessment checklist to ensure it is complete and monitor the return of documents, including corrective action plans. We also recommend the agency ensure personnel responding to the checklist are adequately trained regarding the elements of and necessity for internal controls.

#### Auditee's Response

*The Department concurs.*

*The Office of Operations Review (OOR) has revised the 1997 self-assessment checklist to include evaluation of the areas noted by the Office of the State Auditor.*

*The Office of Accounting Services (OAS) has designated a staff person to monitor the return of the checklists and the completion of the related corrective action plans. The checklist for the Juvenile Rehabilitation Administration has been received by OAS, and OAS has received documentation that all*

*of the corrective action plans have been completed or are in the process of being completed. Additionally, the Department is developing a revised distribution methodology to facilitate the tracking of completed checklists.*

*The Department will use Regional Coordinating Councils (RCCs) that consist of members from the various program areas within DSHS to continually update Regional Administrators and Superintendents. The purpose of the RCCs is to convey information to field staff regarding the importance of sound internal control procedures, as well as addressing other on-going issues within the Department. Proper procedures for completing the checklists will be addressed by the RCC.*

*The Department is developing an internal control training course which will be required for all departmental managers. This course will include the self-assessment checklist.*

#### Auditor's Concluding Remarks

We appreciate the agency's timely response and commitment to resolution of these issues and thank agency staff members for their cooperation and assistance during our audit.

12. The Department Of Social And Health Services (DSHS), Juvenile Rehabilitation Administration, Naselle Youth Camp (NYC) Should Implement Existing Policies And Procedures To Ensure Control Over Consumable Inventory

Naselle Youth Camp has not implemented existing Office of Financial Management and DSHS policies and procedures to ensure control over consumable inventory. We observed the physical count of the commissary, plant and food inventories and found that NYC:

- a. Adjusted actual inventory records to physical inventory counts without investigating the causes of differences.
- b. Omitted an estimated 40 percent of the plant plumbing and electrical equipment from the physical count and inventory records of the institution.
- c. Required inventory teams to perform the physical count by verifying only that items recorded on inventory sheets were on the shelves. Items on the shelves but not on the sheets were ignored.
- d. Arranged the food service inventory stock in a confusing manner, with like items separated in various areas of the storage area.
- e. Did not surplus obsolete items.
- f. Used incorrect commodity codes or substituted generic codes.

The State of Washington Office of Financial Management's (OFM) *Financial and Administrative Policies, Regulations, and Procedures* manual describes the following internal control and accounting requirements for consumable inventory:

Section 2.2.4.4.1:

Control of Inventories. Agencies are to comply with the OFM prescribed inventory policies and procedures.

Section 3.1.1.1.5.c:

Reconciliation - the process of comparing inventory accounting records with the physical count of inventory and resolving differences that occur.

Section 3.1.1.2.2.b:

Perpetual inventory records are to be reconciled with the physical count  
. . . .

Section 3.2.1.3.4.a:

When the physical count is complete, the inventory officer is to reconcile the physical count with the perpetual inventory records. Differences are to be investigated and explained, corrective action instituted when deemed necessary, and the accounting records adjusted . . . .

Section 6.2.2.1.9.e:

Effective control procedures are to be established to ensure that state supplies . . . are used properly and for authorized purposes . . . .

Section 6.2.2.1.9.g:

An actual physical inventory count of all state supplies and equipment is to be made periodically in accordance with OFM's inventory policy. Causes for differences between quantities determined by physical inspection and those shown on accounting records are to be investigated and, to the extent possible, improvements in procedures are to be made to prevent future error or losses . . . .

Section 6.2.2.1.9.k:

Supplies and merchandise are to be arranged so that the earliest received or produced will be issued first.

Section 6.2.2.1.9.m:

Supplies . . . are to be kept neat.

To comply with these OFM requirements, DSHS has included procedures in its *Agency Inventory System* (AIS) manual covering facets of consumable inventory management. Chapter 10.30.A and 10.30.C describe the agency annual physical inventory policies and procedures and the reconciliation process. DSHS also published additional instructions for the fiscal year 1996 inventory. These instructions required inventory takers to:

1. Start at one particular location and continue through the facility in an orderly fashion.
2. Add items counted but not on the inventory list.
3. Ensure all hardware, plumbing, electrical, fuel, lumber, paint and other stock items were part of the stores system before the physical inventory began. No exceptions were allowed.

Because of these deficiencies, there is little assurance that NYC's consumable inventory balance is fairly presented or that the institution has included all state purchased inventory in its records. In addition, conditions a-e significantly increase the potential for loss, unauthorized use, and misappropriation of consumable inventory stock. Condition d makes an accurate count and reconciliation nearly impossible to complete and leads to a lack of assurance that the earliest received items were the first issued.

These conditions have occurred because NYC managers have not placed sufficient emphasis on the implementation of OFM and DSHS procedures.

We recommend that NYC implement and comply with existing OFM and DSHS policies and procedures to ensure control over its consumable inventory.

Auditee's Response

*The Department concurs.*

*Naselle will place additional emphasis on staff training prior to the next physical inventory count to ensure the conditions noted by the Office of the State Auditor are corrected.*

*In addition, the Office of Accounting Services is in the process of implementing a new consumable inventory system at the JRA institutions which will improve the internal control and monitoring over consumable inventory.*

Auditor's Concluding Remarks

We appreciate the agency's timely response and commitment to resolution of these issues and thank agency staff members for their cooperation and assistance during our audit.

13. The Department Of Social And Health Services (DSHS). Mental Health Division (MHD) Should Recover Overpayments To Contractors In A Timely Manner

MHD has not recovered overpayments of approximately \$1,390,000 in state funds made to the North Sound Regional Support Network/Prepaid Health Plan (NSRSN/PHP) from May 1994 through October 1994. For more than two years, the NSRSN/PHP has been attempting to obtain a resolution of this matter from MHD. Through December 1996, the NSRSN/PHP has accrued interest on these funds of approximately \$290,000.

The State of Washington Office of Financial Management *Policies, Regulations, and Procedures* manual states in Section 6.2.2.1.8.j:

Controls are to be established to ensure the prompt follow-up of past due receivables.

According to MHD personnel, the overpayment arose from the inability of the NSRSN/PHP's billing system and MHD's payment system to adapt to changes in the method used to calculate PHP reimbursements. This problem has since been corrected. However, the overpayment itself has not been resolved. The failure to recoup this overpayment has resulted in the unavailability of state funds in the approximate amount of \$1,680,000 in principal and interest for the provision of mental health services.

We recommend that DSHS recover the overpayment and accrued interest of approximately \$1,680,000 or take other steps to resolve the issue and communicate these decisions to the NSRSN/PHP.

Auditee's Response

*The Department believes recovering overpayments from contractors in a timely manner is an important aspect of sound business practice. From the point in time when the overpayment was discovered, the Department has actively sought to resolve the overpayment issue with the North Sound Regional Support Network/Prepaid Health Plan. The Department has issued an overpayment letter to the contractor.*

Auditor's Concluding Remarks

We appreciate the agency's statement that it is now seeking resolution of this issue and thank agency staff members for their cooperation and assistance during our audit.